No. 755.

In the Supreme Court of the United States.

OCTOBER TERM, 1967.

FIRST AGRICULTURAL NATIONAL BANK OF BERKSHIRE COUNTY,
Appellant,

v.

STATE TAX COMMISSION.

ON APPEAL FROM THE SUPREME JUDICIAL COURT OF MASSACHUSETTS.

BRIEF FOR THE STATE TAX COMMISSION.

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Opinion Below.

The opinion of the Supreme Judicial Court of Massachusetts (A. 31-58) is reported at 1967 Mass. Adv. Sh. 1301, 229 N.E. 2d 245.

Jurisdiction.

The judgment of the Supreme Judicial Court of Massachusetts was entered on July 27, 1967, and a final decree was entered on August 9, 1967. Notices of appeal from the judgment and final decree were filed with the Supreme Judicial Court on October 13, 1967, and the appeal was

docketed with the Supreme Court of the United States on October 23, 1967. Probable jurisdiction was noted on January 15, 1968. The jurisdiction of this Court is conferred by 28 U.S.C. § 1257(2).

Questions Presented.

The ultimate question is whether the Constitution and laws of the United States prohibit the Commonwealth of Massachusetts from applying a nondiscriminatory sales and use tax statute to purchases of tangible personal property by a national bank. This raises the following subsidiary questions:

(1) Is a national bank today to be regarded as a federal instrumentality for the purpose of relieving it, on constitutional grounds, from payment of nondiscriminatory state sales and use taxes on its purchases of tangible personal property?

(2) If it should be held that affirmative action by Congress is required for the enactment by a state of a sales tax in cases where its legal incidence falls on a national bank, is there any sufficient reason for not accepting the determination of the Massachusetts Supreme Judicial Court that the legal incidence of the Massachusetts sales tax does not fall on the bank as a purchaser, and thus raises no question of either a constitutional or a statutory immunity of a national bank from a sales tax on its purchases?

(3) Is 12 U.S.C. § 548, to be regarded as impliedly prohibiting the Commonwealth of Massachusetts from imposing (*a*) its use tax on purchases of tangible personal property by national banks and (*b*) its sales tax on such purchases if the legal incidence of the latter tax should be regarded as falling upon a purchaser?

Statutes and Regulations Involved.

The Massachusetts Sales and Use Tax Law (St. 1966, c. 14, § 1 and § 2, as amended by St. 1966, c. 483) is set forth, in pertinent part, at page 57 et seq. of the appendix to the appellant's brief. The State Tax Commission's Emergency Regulation No. 6 is set forth at page 74 thereof. Section 548 of Title 12, U.S.C., the federal statute involved, is set forth at page 55 et seq. thereof.

Statement.

The appellant is a national bank organized under 12 U.S.C. § 21 et seq. and located in the Commonwealth of Massachusetts. The appellee is the Commonwealth's State Tax Commission. By a bill for declaratory relief (A. 2-15) filed before a single justice of the Massachusetts Supreme Judicial Court, who reserved and reported the case without decision to the full bench (A. 30), the appellant sought a binding declaration that its purchases of tangible personal property are exempt under the Constitution and laws of the United States from the Massachusetts sales and use taxes imposed by St. 1966, c. 14, §§ 1 and 2.[1] That statute exempted "Sales which the commonwealth is prohibited from taxing under the constitution or laws of the United States." Sec. 1, subsec. 6(a), and sec. 2, subsec. 5(b) (Appendix to appellant's brief, pp. 58 and 71). Nothing in the statute exempted banks as such.

The appellant's bill for declaratory relief also sought (A. 8, prayer 5) a binding declaration of the alleged in-

[1] Although a temporary statute, which expired on December 31, 1967 (§ 79), the act has since been made permanent in all respects material to this case. St. 1967, c. 757, inserting chapters 64H and 64I into the Massachuetts General Laws.

validity of Emergency Regulation No. 6 of the Commission (A. 26) that "The sale, lease or rental of tangible personal property to national banks . . . is subject to the sales and use tax."

The case was heard by the full bench of the Supreme Judicial Court on a statement of agreed facts, a "Case Stated" (A. 17-29), which contained the foregoing facts and also stipulations that there are ninety national banks in Massachusetts (A. 19); that the appellant has paid Massachusetts sales and use taxes on its purchases (A. 18); that the appellant "will be unable to carry on its banking operations unless it continues to make purchases" which, by the terms of the regulation, are subject to the sales and use taxes (A. 19); and that "Massachusetts vendors have refused to make retail sales of tangible personal property to the [appellant] unless the [appellant] agrees that it will reimburse such vendors for the Massachusetts sales tax thereon" (A. 19).

The full bench of the Massachusetts Supreme Judicial Court ruled that the appellant's purchases were subject to both the sales and the use taxes (A. 31-58). Treating the sales tax and the use tax separately, the court held, with regard to the former, that its legal incidence did not fall on purchasers, but rather on vendors, and that in consequence the bank was not entitled to an exemption on its purchases. With regard to the use tax, the court held that, even though its legal incidence falls on purchasers, a national bank was not entitled to an exemption under either the Constitution or the laws of the United States. A final decree was then entered declaring the Commission's regulation to be "valid in so far as it rules that purchases of tangible personal property by national banks are subject to the Massachusetts sales and use taxes, St. 1966, c. 14, secs. 1 and 2" (A. 60-61). This appeal followed (A. 61-62).

Summary of Argument.

The essence of the position of the State Tax Commission is that national banks today are private business enterprises and are therefore not entitled to a constitutional immunity from nondiscriminatory state sales and use taxes on their purchases; that, in any event, although the legal incidence of the Massachusetts use tax concededly falls on the banks as purchasers, the legal incidence of the Massachusetts sales tax does not, so that this case actually presents only a question of immunity from the use tax; and, finally, that 12 U.S.C. § 548 does not prohibit the imposition of the use tax and is, in any event, inapplicable in the present case to the sales tax, since its legal incidence does not fall on the appellant as a purchaser.

We begin by tracing the origin and development of national banks. The laws under which they are organized date back to the National Currency Act of 1863, an act to establish a uniform national currency and extend the market for government bonds. That measure created a national free banking system under which private parties could obtain federal banking charters by pledging government bonds with the government as security for bank notes which the government would then provide for use as a circulating medium.

The need for a larger market for government bonds was brought on by the financial burdens of the Civil War. The need for a uniform national currency had already existed for some time because of the disruptive monetary effects of the multiform, depreciated and often spurious state bank notes then in circulation. Even after the National Currency Act of 1863, these notes continued to circulate, but in 1866 they were finally eliminated by the imposition of a prohibitive tax.

The passing of the state bank notes and the creation of the national bank notes temporarily improved the nation's currency. Yet the new notes, because of their fixed connection with the government bond market, soon proved to be gravely deficient. Their chief weakness was their inelasticity; that is, their inability to expand and contract according to the changing demands of business and agriculture. By the year 1910, following a series of financial crises and panics, it was generally agreed that the national bank notes should be replaced by a more elastic currency. It was also generally agreed that there were other serious deficiencies in banking operations and structure and that fundamental reforms were required to ensure mobilization and concentration of reserves, cooperation among banks and stabilization of banking on a nationwide basis.

The Federal Reserve Act in 1913 was enacted to correct the many shortcomings of the existing banking units. It established the Federal Reserve System as a central banker and provided, among other things, for a new type of bank note currency, Federal Reserve notes, and it also provided for the eventual retirement of the national bank notes.

In 1935 the bonds that then secured the national bank notes were called for redemption, whereupon the note-issuing functions of the national banks ceased. This also marked the end, if it had not sooner occurred, of any significant banking difference between the national and the state banks.

Long before 1935, in fact, Congress and this Court had recognized the commercially competitive relationship between the national and the state banks. Powers of national banks had been enlarged to permit them to engage in banking business of the same type as that carried on by the state banks. In enlarging these powers, Congress usually

adopted the law of the states where the banks were located as the measure of the new grants of authority. Similarly, this Court, when Congress has not legislated, has held the national banks to be subject to the laws of the states where they carry on their business unless it could be demonstrated that the state laws incapacitated the banks from discharging their functions. Hence, even if national banks might *arguendo* be regarded, for some purposes, to be federal instrumentalities, they should not be given a constitutional exemption from nondiscriminatory sales and use taxes.

Actually, national banks today do not meet the tests of a federal instrumentality. None of the criteria employed in determining whether an institution qualifies as such an instrumentality are satisfied by national banks as now constituted. From whatever aspect a national bank is viewed today, it performs no significant functions for the use of the government nor does it serve as an agent to execute governmental policy.

The judicial decisions, such as *Owensboro National Bank* v. *Owensboro,* 173 U.S. 664, that have held national banks to be federal instrumentalities were handed down when national banks still issued bond-secured notes as currency. Moreover, they relied on *M'Culloch* v. *Maryland,* 4 Wheat. 316, and *Osborn* v. *Bank of the United States,* 9 Wheat. 738, which concerned a significantly different bank, the Second Bank of the United States. When established in 1816, the Second Bank was a true central bank designed to eliminate the acute currency disorders following the War of 1812 and to serve as the fiscal agent of the government. Whatever significance the note-issuing functions of the variety of national banks that were formed under the Civil War legislation may have had in creating some resemblance between these banks and the great Second Bank of the United States, not even that feature exists today.

Our argument next considers the legal incidence of the Massachusetts sales tax. This question is important since any constitutional or statutory immunity claimed by the appellant depends on whether it bears the legal incidence of the taxes of which it complains. Concededly, the appellant as a purchaser bears the legal incidence of the use tax.

Determination of the sales tax question depends on the Massachusetts court's decision as to what rights and liabilities the Massachusetts statute has established. In respect of these determinations, the decision is not reviewable. To the extent that any federal question is involved, it must therefore be resolved on the basis that it does not reopen the underlying construction of the statute by the state court.

After full consideration of the statute, the Massachusetts court held that the legal incidence of the sales tax does not fall on the bank as a purchaser, since only the vendor is responsible for the payment of the tax to the state. This construction, which has the effect of fixing the meaning and effect of the law in Massachusetts, fully comported with federal criteria, as established by this Court, and should be accepted as determinative of the question of the legal incidence of the sales tax on this appeal.

Finally, we consider the application of 12 U.S.C. § 548. We point out that it does not affirmatively purport to grant exemptions from state taxation of national banks, but only purports to regulate the mode of taxation of the shares thereof. We then argue that, since tax exemptions should not be implied, no exemption from a nondiscriminatory sales and use tax should be read into the statute. Denial of any implied exemption would be consistent with the original purpose underlying the enactment of section 548 in 1864 and would avoid the ironical result of using a statute that was designed to protect national banks from dis-

criminatory taxation as a device to confer on them a special preference. Cases which have said that section 548 is the exclusive basis of the jurisdiction of the states to tax national banks have, we maintain, departed from the original understanding of Congress in adopting that section. Finally, we point out that a nondiscriminatory use tax is inherently equal as between state and national banks and does not require action by Congress or this Court to ensure its nondiscriminatory application.

Argument.

I. A National Bank Today is a Strictly Private Business Enterprise that Performs No Functions of Sufficient Governmental Importance to Entitle it to Any Constitutional Exemption from Nondiscriminatory State Sales and Use Taxes.

A. The Origin of National Banks and Their Once Distinctive Feature—Bond-Secured Bank Notes..

The more than 13,000 national banks today, all privately organized, owned and financed, originated in the financial bewilderment of the Civil War.[1] The charter of the Second Bank of the United States having expired in 1836 and no federally chartered bank having been created as a successor, banking at the outbreak of the War was wholly in

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[1] For the origin of the national banks see Andrew MacFarland Davis, "The Origin of the National Banking System," National Monetary Commission (1910); Paul Studenski and Herman E. Kroos, "Financial History of the United States" (2d ed., 1963), pp. 137-155; Thomas J. Anderson, Jr., "Federal and State Control of Banking" (1934), pp. 53-88; Bray Hammond, "Historical Introduction," in "Banking Studies," Federal Reserve System (1941), pp. 10-14. For current statistics on the numbers and types of banks see Annual Report of the Comptroller of the Currency for 1965-1966, p. 13.

the hands of state institutions. Although the country was nominally on a specie basis, the amount of specie in circulation was insignificant, and was even further reduced in December, 1861, when the state banks and then the federal government itself, as Union finances deteriorated, suspended specie payments. Acute need for funds to support the War quickly brought about the enactment of the Legal Tender Act on February 25, 1862 (12 Stat. 345), to authorize the issue of government notes or greenbacks, but these proved to be a weak, and soon a depreciated, support for the North's money.

A major portion of the circulating currency and of the total stock of money, both before and after the issue of the greenbacks, consisted of state bank notes. Commercial banking was still at that early and crude state of development, in theory and practice, at which the issuance of bank notes rather than the creation and transfer of demand deposits and the distribution of credit was its distinctive feature. See Henry E. Miller, "Banking Theories in the United States before 1860" (1927), pp. 12, 14. In 1862 there were 1,600 state banks issuing 7,000 varieties of notes, plus 3,000 varieties of altered notes, 1,700 varieties of spurious notes, and 800 varieties of imitations. Davis R. Dewey, "Financial History of the United States" (12th ed., 1936), p. 322. The notes had no standard value, some passing at par, others at a discount, others for nothing.

The chaotic condition of the state bank notes and the need for reform were described in picturesque terms by a contemporary observer:

> "In the West the people have suffered for years from the issues of almost every State in the Union, much of which is so irredeemable, so insecure, and so unpopular as to be known by opprobrious names rather than the money it pretends to represent. There the frequently

worthless issues of the State of Maine and of other New England States, the shinplasters of Michigan, the wild cats of Georgia, of Canada, and Pennsylvania, the red dogs of Indiana and Nebraska, the miserably engraved notes of North Carolina, Kentucky, Missouri, and Virginia, and the not-to-be-forgotten stumptails of Illinois and Wisconsin are mixed indiscriminately with the par currency of New York and Boston, until no one can wonder that the West has become disgusted with all bank issues and almost unanimously demand that such a currency shall be taxed out of existence, and give place to a uniform national currency." Quoted in Andrew MacFarland Davis, "The Origin of the National Banking System," National Monetary Commission (1910), p. 14.

Counterfeiting of the state bank notes was a major source of monetary insecurity. A contemporary observer reported:

"One phase of our paper currency engendered by this multiform system calls for special notice and consideration. We refer to counterfeiting. It may be safely stated that the art, as pursued in the United States, is without parallel, and that without vaunt or hyperbole, we can 'beat the world' on this, our national specialty—counterfeiting. A species of literature, even unknown to the rest of the world, has been initiated among us, and no merchant or mechanic deems himself safe unless he consults the 'Counterfeit Detector.' . . ." Quoted in Davis, "The Origin of the National Banking System," *supra*, p. 25.

Proposals that Congress eliminate the currency chaos began, it may be said, with a report by Secretary of the

Treasury Salmon P. Chase in December, 1861, urging the creation of a uniform national currency. It was not until February, 1863, however, that Congress acted. Merging in one measure the double objective of creating a uniform national currency and extending the market for government bonds, sorely needed at that time in place of more greenbacks, to finance the Civil War, Congress passed "An Act to provide a national Currency, secured by a Pledge of United States Stocks, and to provide for the Circulation and Redemption thereof" (Act of February 25, 1863, c. 58, 12 Stat. 665, soon amended and replaced by the Act of June 3, 1864, c. 106, 13 Stat. 99). This act, called the National Currency Act, to give it its correct name, established a national free banking system by which five or more private persons could, upon satisfying certain capital requirements and depositing a specified amount of United States bonds with the Comptroller of the Currency, receive a federal charter "to carry on the business of banking" (§ 8) in their local community (§§ 5, 7, 14, 16; references are to the 1864 version). Against the security of the deposited bonds, which were limited to certain issues and were accordingly said to have the circulation privilege, the Treasurer of the United States was to issue as obligations of a depositing bank circulating notes equal to 90 per cent of the lesser of the par or market value of the bonds (§ 21). These notes were receivable for all debts, other than import duties, owed to the United States (§ 23). Each bank was eligible upon posting certain security to be a depository of federal funds (§ 45). However, the Independent Treasury System, which had been established in 1846, continued to exist side by side and to be a depository for the government's funds. Not until 1921 was it abolished. (See Paul Studenski and Herman E. Kroos, "Financial History of the United States" (2d ed., 1963), pp. 119-120, 250-251, 261.)

Although the National Currency Act allowed state banks to obtain federal charters, the state banks, preferring their state parentage, were slow to convert. In consequence, notes of state banks, with all their former irregularities and unsettling influences, continued to circulate alongside the bond-secured notes of the new federally chartered banks. When it became clear that the state banks would not voluntarily seek federal charters, steps were taken to compel them to do so. Taxation was the device employed. To drive the state bank notes into retirement and to force the state banks, thus deprived of their distinctive function, to convert to federal charters, the Act of July 13, 1866, c. 184, 14 Stat. 98, taxed the notes at the prohibitive rate of 10 per cent (§ 9). (See *Veazie Bank* v. *Fenno,* 8 Wall. 533, upholding the tax.) The tax was successful in forcing the notes into retirement, but it nevertheless failed to eliminate the state banks. A number of the banks, it is true, converted at first, but soon the rapid development of demand deposits as the distinctive feature of commercial banking, together with an expanded role for banks as fiduciaries, opened new areas of profitable banking activity. In consequence, the state banks were not only able to survive; they increased and expanded and became vital elements in the country's banking structure.

The growth of deposit banking after the Civil War has been described by two scholars:

> "In 1867, the public divided its stock of money almost equally between deposits and money: it held about $1.20 of deposits for each dollar of currency . . . In the five years after 1867, deposits rose to $2 for each dollar of currency. That increase reflects the rapid post-Civil War growth and spread of commercial banking." Milton Friedman and Anna J. Schwartz, "A Monetary History of the United States 1867-1960" (1963) p. 16.

B. The Decline of the National Bank Notes.

The passing of the state bank notes and the creation of national bank notes represented a major improvement in the composition of the nation's currency. Yet within the new system lay the seeds of its own destruction. The essential defect was tying the amount of bank note currency to the condition of the government bond market and failing to consider the critical credit requirements of business and agriculture. This defect, which made the national bank notes extremely inelastic and even created what has been called "perverse elasticity," prevented the volume of bank notes from increasing or decreasing according to the public's demand for credit. When business was good and an increase in bank note circulation was desirable, the price of government bonds tended to rise, discouraging banks from buying more bonds as a base for further bank note issues. On the other hand, when business was bad and a contraction of the amount of currency was warranted, the price of government bonds declined, encouraging banks to buy more bonds, which then became the base for augmenting an already redundant currency.

This unresponsiveness of the national bank notes to the varying needs of trade and industry, along with other defects of the national banking system—the failure to provide either an adequate discount market for commercial paper, or an adequate system of mobile and centralized bank reserves or an adequate system of check clearance—not only rendered the national banks gravely ineffective in meeting the public's need for credit and banking facilities; it also tended to accentuate the all too frequent financial crises with which the economy was periodically confronted. Although it might be an overstatement to assert that the deficiencies in the national banking system brought on the panics of 1873, 1884, 1893 and 1907, it could, we submit,

correctly be said that these deficiencies intensified each of these crises after they began.

By the year 1910 it had become plain to every student of the subject that national bank notes should be replaced by another form of currency. As one scholar wrote in that year:

> "The sum of the whole matter is that under the existing system of bank notes based upon government bonds, normal and automatic expansion and contraction of the currency, in response to needs of trade, is flatly impossible. The currency supply may be greatly enlarged in the dull midsummer months and suddenly contracted when the active autumn business season begins. It may increase rapidly at a time when trade reaction has reduced to a minimum the necessities for even the existing bank note supply, or it may be as rapidly reduced when large harvests, full employment of labor, and active hand-to-hand use of currency, most need a larger circulating medium. That there is no remedy for this abnormal situation, except the substitution of some other system for that which prescribes the United States Government bond as a basis for bank note issues, every economist at all familiar with the question agrees. It is only when discussion converges on the system which is to be substituted, that difference of opinion is encountered." Alexander D. Noyes, "History of the National-Bank Currency," National Monetary Commission (1910), p. 20.

C. The End of the National Bank Notes.

Certain ineffectual steps had already been taken in 1900 and 1908 to bolster the now discredited national bank note currency. The Currency Act or Gold Standard Act of 1900 (Act of March 14, 1900, c. 41, 31 Stat. 45) authorized, among

other things, national bank notes to be issued up to the full par value of the bonds deposited as their security, instead of 90 per cent as previously (§ 12), and it also reduced the circulation tax to which such notes were then subject (§ 13). In 1908 the Aldrich-Vreeland Act (Act of May 30, 1908, c. 229, 35 Stat. 546) made further changes by authorizing groups of national banks to form national currency associations through which the banks could issue an "emergency currency," as it came to be called, upon the security of 90 per cent of the market value of certain state and local bonds and up to 75 per cent of the cash value of other securities or commercial paper (§ 1). Authority for such issues was to expire on June 30, 1914 (§ 20). Foreshadowing a thorough revision of the country's banking structure, the act established a National Monetary Commission to study and make recommendations relative to the nation's money and banking system (§§ 17-19).

On January 9, 1912, following the publication of more than twenty volumes of scholarly studies of banking institutions and practices, both in the United States and abroad, the Commission filed its report (Senate Doc. No. 243, 62d Cong., 2d Sess.). The existing banking structure was indicted, to cite only some of the grounds, for its failure to provide for the concentration and mobilization of reserves, its inability to adjust to fluctuations in the demand for credit, its failure to provide for effective cooperation among banks, its failure to provide a broad discount market for commercial paper, and its failure to coordinate and stabilize banking functions and resources on a nation-wide basis (ibid. pp. 6-9). Among the gravest of the deficiencies found in the existing system was the national bank note currency. Of this the Commission said:

> "Of our various forms of currency the bank-note issue is the only one which we might expect to respond

> to the changing needs of business by automatic expansion and contraction, but this issue is deprived of all such qualities by the fact that its volume is largely dependent upon the amount and price of United States bonds." (Ibid. p. 7.)

The Commission also criticized the existing system of keeping government funds in the erratic Independent Treasury System, which tended to be a disruptive influence through its sudden and irregular additions and withdrawals. Supplemental use of national banks as depositories had resulted in charges of discrimination and favoritism (ibid. p. 9).

Included in the report were recommendations for broad and pervasive changes. Especially pertinent to the present case was a proposal that the national banks should not issue any more bank notes (ibid. p. 17).

This and the other recommendations led in the following year to the enactment of the Federal Reserve Act, "An Act to provide for the establishment of Federal reserve banks, to furnish an elastic currency, to afford means of rediscounting commercial paper, to establish a more effective supervision of banking in the United States, and for other purposes" (Act of December 23, 1913, c. 6, 38 Stat. 251).

The general structure of the Federal Reserve System is too familiar to be described here. We call the Court's attention, however, to certain provisions of the Federal Reserve Act which underscore the decline in the relationship of national banks to the government. Acknowledging the failure of the national bank notes and deciding to tamper with them no longer, the new act created a new kind of bank currency, Federal Reserve notes. Each Federal Reserve Bank was authorized to issue these new notes upon the security of 100 per cent commercial paper and a reserve

of 40 per cent gold or gold certificates, including a 5 per cent redemption fund (§ 16). Each such bank was also authorized to buy and sell government obligations (§ 14b). Also pertinent was a section which authorized the Treasurer of the United States to deposit public funds in the Federal Reserve Banks, "which banks, when required by the Secretary of the Treasury, shall act as fiscal agents of the United States; . . ." (§ 15).

Were it not for the danger of unduly contracting the currency and subjecting the national banks to losses on certain government bonds which had the circulation privilege and thereby had a value far above their investment value, the Federal Reserve Act would in all likelihood have ended the existence of national bank notes in 1913. Edwin W. Kemmerer, "The ABC of the Federal Reserve System" (11th ed., 1938), p. 61. However, to allow an orderly liquidation of the national bank notes and their supporting security, the Federal Reserve Act provided instead that, if national banks desired to sell their pledged bonds, the Federal Reserve Board should direct [illegible] Reserve Banks to purchase them, up to certain limits each year after 1915, whereupon the notes were to be retired (§ 18). It was expected that this process would take about twenty years (Davis R. Dewey, "Financial History of the United States" (12th ed., 1936), p. 493). Eventually, after some fluctuations in the supply, it was completed. On March 11, 1935, the Secretary of the Treasury called for redemption all the bonds then possessing the circulation privilege. Each national bank was required to deposit with the Secretary the proceeds of its redeemed bonds, to hold as a fund to redeem the notes which the bonds had secured. The Treasury, in turn, assumed, as a noninterest-bearing obligation of the United States, the bank notes to which the redeemed bonds pertained. Thereafter as these notes, which had then ceased to be obligations of the national banks, were received by the

Federal Reserve Banks in the usual course of business, they were delivered to the Treasury and retired (see Annual Report of the Board of Governors of the Federal Reserve System for 1935, pp. 27-28). The redemption of the bonds possessing the circulation privilege meant, of course, that national banks could not thereafter issue any new bank notes.

The passing of the national bank notes evoked no laments. It "eliminated a concentrated headache which had existed since 1863 . . ." Paul Studenski and Herman E. Kroos, "Financial History of the United States" (2d ed., 1963), p. 393. It was "[o]ne phase of the Roosevelt Administration's currency policies with which no monetary economist can find fault . . . The various shortcomings of the national bank notes, such as inelasticity, perverse elasticity, and the like, are too familiar to require comment. . . ." James D. Paris, "Monetary Policies of the United States, 1932-1938" (1938), p. 90.

The abolition of the national bank notes meant the end of any significant difference between national and state banks. It has been said:

> "With the passing of the national bank notes, the United States lost much of the difference between the national banking system and the state banking systems. Except for automatic membership in the Federal Reserve System, different examining boards, and more or less different standards of examination, appraisal and the like, the main point of differentiation between the national banking system and any strict banking system, as in New York State, was formerly the privilege of currency issue." James D. Paris, *supra*, p. 96.[1]

[1] *Cf. Colorado National Bank of Denver* v. *Bedford*, 310 U.S. 41, 48.

It is of interest also to record that eventually the Federal Reserve System itself ceased to have any official function in stabilizing the government securities market. On March 4, 1951, following the inflationary pressures of the Korean War, a conflict between the credit-control responsibilities of the Board of Governors of the Federal Reserve System and the debt-management responsibilities of the Treasury brought about the famous Accord which marked the end of the Federal Reserve System's support of the government securities market. Annual Report of the Board of Governors of the Federal Reserve System for 1951, pp. 3, 98; Annual Report of the Secretary of the Treasury for the Fiscal Year Ended June 30, 1951, p. 271; C. Richard Youngdahl, "Open-Market Operations," in "The Federal Reserve System," Herbert V. Prochnow ed. (1960), pp. 113, 132.

D. Both Congress and This Court have Encouraged Competitive Equality between State and National Banks; under This Doctrine Neither Class of Banks Receives Any Special Favor.

Development of state banks alongside the national banks has created what is generally known as the dual banking system. This term today, however, scarcely describes with accuracy the complex and comprehensive controls to which banks are now subject. If it is intended to suggest that state banks are not subject to federal control, it is highly erroneous. Few state banks, whether or not they are members of the Federal Reserve System, are not subject to some form of supervision by the Comptroller of the Currency, the Federal Reserve System, and the Federal Deposit Insurance Corporation. Howard H. Hackley, "Our Baffling Banking System," 52 Virginia L. Rev., pp. 565,

771, 814 (May and June, 1966). Yet the term "dual banking system" sufficiently indicates that state banks hold state charters and national banks hold federal charters.

Rivalry between the two classes of banks has engendered numerous equalizing amendments to the National Bank Act (the act by which the original National Currency Act is now known (12 U.S.C. § 38)). Without authority to loan upon the security of real estate until 1913, national banks were authorized in that year to loan on improved farmland (§ 24 of the Federal Reserve Act). This power was expanded in 1916 to include certain other classes of real estate (Act of September 7, 1916, 39 Stat. 752), and then, in 1927, by the McFadden Act, it was extended without restriction to all improved real estate. Act of February 25, 1927, c. 191, 44 Stat. 1224, § 16.

Power to act as a fiduciary was first given to national banks in 1913 by the Federal Reserve Act (§ 11(k)), amended by the Act of September 26, 1918, c. 177, 40 Stat. 967, § 2. The McFadden Act, *supra,* authorized branch banking (§ 7) (see *First National Bank of Logan* v. *Walker Bank & Trust Co.,* 385 U.S. 252, 261), liberalized requirements for capitalization (§ 4), and authorized payment of interest on deposits (§ 16).

In expanding the powers of national banks, Congress has often assimilated the new powers to those possessed by state banks in the particular states where the national banks are located. Examples of the adoption of state law are found in the provisions relative to branches (12 U.S.C. § 36(c)); capitalization (12 U.S.C. § 51); interest rates (12 U.S.C. § 85); conversion of charters from federal to state and vice versa, and mergers (12 U.S.C. § 214c); contributions to charity (12 U.S.C. § 24 (eighth)); and receiving deposits of public moneys (12 U.S.C. § 90; see *Lewis* v. *Fidelity & Deposit Co. of Maryland,* 292 U.S. 559). Further,

Congress has authorized the states to regulate bank holding companies involving both national and state banks (12 U.S.C. § 1846).

In cases where Congress has not explicitly made national banks subject to state law, judicial decision has often done so. Examples are found in cases involving the escheat of abandoned bank deposits, *Anderson National Bank* v. *Luckett,* 321 U.S. 233; setting aside preferences by an insolvent debtor, *McClellan* v. *Chipman,* 164 U.S. 347, and branch banking, *First National Bank in St. Louis* v. *Missouri,* 263 U.S. 640 (a case arising before the McFadden Act). As stated in *Anderson National Bank* v. *Luckett, supra:*

> "This Court has often pointed out that national banks are subject to state laws, unless those laws infringe the national banking laws or impose an undue burden on the performance of the banks' functions." (p. 248.)

Earlier this Court, in a tax case, stated the foregoing doctrine in these words:

> "They [the national banks] are subject to the laws of the State, and are governed in their daily course of business far more by the laws of the State than of the nation. All their contracts are governed and construed by State laws. Their acquisition and transfer of property, their right to collect their debts, and their liability to be sued for debts, are all based on State law. It is only when the State law incapacitates the banks from discharging their duties to the government that it becomes unconstitutional." *National Bank* v. *Commonwealth,* 9 Wall. 353, 362.

A like test was enunciated by this Court in *First National Bank in St. Louis* v. *Missouri,* 263 U.S. 640:

> "[N]ational banks, are subject to the laws of a State in respect of their affairs unless such laws interfere with the purposes of their creation, tend to impair or destroy their efficiency as federal agencies or conflict with the paramount law of the United States." (p. 656.)

The appellee respectfully submits that under the foregoing criteria a national bank (assuming *arguendo* that for some purposes it may be regarded as a federal instrumentality) cannot successfully assert a constitutional immunity either from a nondiscriminatory state use tax on its purchases or, if the legal incidence of a sales tax should fall upon it, from a nondiscriminatory sales tax either. Such taxes fall equally on all purchasers. To assert that a national bank's payment of these taxes would "impose an undue burden on the performance of the banks' functions" (*Anderson National Bank* v. *Luckett, supra,* at p. 248) or would incapacitate the banks from discharging their duties, if any, to the federal government (*National Bank* v. *Commonwealth, supra,* at p. 362) or would "tend to impair or destroy their efficiency as federal agencies [assuming them to be such]" (*First National Bank in St. Louis* v. *Missouri, supra,* at p. 656) is, we submit, refuted by the mere statement of the proposition. To sanction an exemption from such taxes today would ignore the wholly private commercial character of a national bank and would amount to a rejection of the historic doctrine of competitive equality. The granting of such an exemption would be nothing less than the award of an inequitable preference to a favored class of business enterprise. In today's bank-

ing world, moreover, it would raise serious questions of a denial of equal protection of the laws. It would also ignore the many decisions of this Court on what the necessary elements of a federal instrumentality are.

E. A National Bank Today does Not Meet the Tests of a Federal Instrumentality.

Although it is true that "there is no simple test for ascertaining whether an institution is so closely related to governmental activity as to become a tax-immune instrumentality" (*Department of Employment* v. *United States*, 385 U.S. 355, 358-359), the criteria that have been employed by this Court in recent years would, we submit, plainly exclude national banks, as they are now constituted, from being so regarded. Various formulations of the controlling criteria have been adopted—whether the institutions "have been so incorporated into the government structure as to become instrumentalities of the United States" (*United States* v. *Boyd*, 378 U.S. 39, 48, involving a private contractor); whether the institutions "are integral parts of [a governmental department and] share in fulfilling the duties entrusted to it" (*Standard Oil Co. of California* v. *Johnson*, 316 U.S. 481, 485, involving Army post exchanges); or are "assimilated by the Government as to become one of its constituent parts" (*United States* v. *Township of Muskegon*, 355 U.S. 484, 486, involving a private contractor using government property); or whether the institution is regarded "virtually as an arm of the Government" (*Department of Employment* v. *United States*, *supra*, at pp. 359-360, involving the Red Cross).

Each institution is judged on its own facts, and national banks today should be no exception. The mere fact that an institution holds a federal charter does not entitle it to

enjoy the status of a federal instrumentality. *Railroad Co.* v. *Peniston,* 18 Wall. 5, 36. Similarly the holding of a permit from the federal government does not give a business enterprise an official status. *Broad River Power Co.* v. *Query,* 288 U.S. 178. To be eligible for such a special position, an institution must establish that its exclusive or at least its dominant aim is to perform a function that the government, but for the existence of the institution, would in all likelihood be required to perform itself. This we believe to be the true teaching of the cases decided by this Court. See *Clallam County* v. *United States,* 263 U.S. 341, 345; *Standard Oil Co. of California* v. *Johnson,* 316 U.S. 481; *Federal Land Bank of St. Paul* v. *Bismarck Lumber Co.,* 314 U.S. 95; *Department of Employment* v. *United States,* 385 U.S. 355. It is, as we shall attempt to demonstrate in a subsequent part of this brief, the true teaching of *M'Culloch* v. *Maryland,* 4 Wheat. 316.

Although the facts of each case are different, we note some of the characteristics which this Court has regarded as relevant to the determination of whether an institution is to be regarded as a federal instrumentality: Is it organized for private profit? (*United States* v. *Township of Muskegon,* 355 U.S. 484, 486); is it a servant of the United States in agency terms? (ibid. p. 486); is it organized only for the convenience of the United States to carry out its ends? (*Clallam County* v. *United States,* 263 U.S. 341, 345); is it organized to effectuate a *specific* governmental policy? (*Federal Land Bank of St. Paul* v. *Bismarck Lumber Co.,* 314 U.S. 95, 102, wherein it was stated that "Through the land banks the federal government makes possible the extension of credit on liberal terms to farm borrowers"); do governmental officials handle its finances and in fact control its operations? (*Standard Oil Co. of California* v. *Johnson,* 316 U.S. 481, involving Army post exchanges); are its of-

ficials or any significant portion of them appointed by the government? (*Department of Employment* v. *United States,* 385 U.S. 355, 359); does the government give it financial aid? (ibid.); is it charged by law with carrying out the government's international commitments? (ibid.); does it perform functions indispensable to the working of the Armed Forces? (ibid.).

The foregoing catalog is not intended to be exhaustive but it does, we submit, indicate the kinds of facts that must be present today to entitle an institution to enjoy the special status of a federal instrumentality. Ultimately, in each case, all facts must be examined in the light of a standard, and that standard, we submit, has as one of its essential elements the discharge of a peculiarly governmental function. Application of that standard, in turn, necessitates a detailed analysis of the purpose and character of the legislation on which the particular claim for an exemption relies. *Shaw* v. *Gibson-Zahniser Oil Corp.,* 276 U.S. 575, 578.

If national banks could at any time have been regarded as discharging a governmental function, their role in that regard has now plainly come to an end. They no longer issue or support any currency or provide an assured market for government bonds, and they do not now provide, if they ever did, any significant fiscal services to the government. Today any bank, federal or state, may be a government depository (12 U.S.C. § 265). The principal checking accounts of the government are carried today, not by national banks, but rather by the Federal Reserve Banks. When a new issue of government securities is offered, the Federal Reserve Banks receive the applications of interested purchasers. When government securities are to be redeemed or exchanged, the transactions are handled by the Federal Reserve Banks. These same banks administer

for the Treasury the tax and loan deposit accounts of the banks in their respective districts. See Board of Governors of the Federal Reserve System, "The Federal Reserve System—Purposes and Functions" (5th ed., rev. 1967), pp. 274-277. The functions of national banks, on the other hand, are merely the usual functions of other privately owned and managed commercial banking institutions.

That national banks have a distinctively private character is now recognized in both anti-trust and labor law. See *United States* v. *Philadelphia National Bank*, 374 U.S. 321 (anti-trust); *United States* v. *First National Bank & Trust Co. of Lexington*, 376 U.S. 665 (anti-trust); *National Labor Relations Board* v. *Bank of America National Trust & Savings Association*, 130 F. 2d 624 (9th Cir.) (labor law). And it is also recognized in federal taxation, national banks being subject to the federal income tax law (26 U.S.C. § 581, 26 C.F.R. § 1.581-1).

F. Owensboro National Bank v. Owensboro, 173 U.S. 664, is Not a Valid Precedent Today.

On the basis of the foregoing considerations, it is difficult to see how a national bank today can be regarded as a federal instrumentality. Any such holding today must rely on the originally questionable and now eroded case of *Owensboro National Bank* v. *Owensboro*, 173 U.S. 664, decided in 1899, in which this Court, at pp. 667-668, quoted with approval a statement in *Davis* v. *Elmira Savings Bank*, 161 U.S. 275, 283, in 1895, that "National banks are instrumentalities of the Federal government, created for a public purpose, and as such necessarily subject to the paramount authority of the United States." These principles, the Court said in *Owensboro* (p. 667), were "settled" in *M'Culloch* v. *Maryland*, 4 Wheat. 316, and *Osborn* v. *Bank of the United States*, 9 Wheat. 738.

Whatever may have been the validity of the statement in *Davis* in 1895 or its restatement in *Owensboro* in 1899 that "National banks are Federal instrumentalities," the events since that time, which we have already related, completely refute its applicability today. Even in the last decade of the nineteenth century, we suggest, it was of doubtful validity.

M'Culloch v. *Maryland*, and *Osborn* v. *Bank of the United States*, on which *Owensboro* relied, related, of course, to the Second Bank of the United States, a wholly different institution from the congeries of isolated, uncoordinated banks organized under the National Currency Acts of 1863 and 1864. The Second Bank was chartered by Congress in 1816 following a period of financial chaos after the War of 1812. The charter of the First Bank of the United States having expired in 1811, there was no bank possessing a federal charter. Banking was carried on entirely by state institutions, each of which issued as currency its own varieties of bank notes. The banks were too easily organized and too lightly supervised; they were undercapitalized, badly and often corruptly managed, and lacking in sufficient reserves. Their underpinnings crumbled when the shock of the British raid on Washington in 1814 brought on a general run for specie. Unable to meet the demand, all banks, except in New England, suspended specie payments in August and September of that year. Bray Hammond, "Banks and Politics in America from the Revolution to the Civil War" (1957), p. 227.

Hoarders collected the remaining specie, leaving no common circulating medium in general use. In consequence, the country's monetary and banking system fell into acute disorder and nearly collapsed. Bank notes, if they passed at all, did so at varying and uncertain discounts, both from state to state and from place to place within the same state.

The effect on the government's finances was disastrous. ". . . [T]he administration failed to redeem treasury notes at Boston, Philadelphia, and New York; it actually paid some of its soldiers in bank notes which were not receivable in discharge of taxes; it could not obtain funds 'to defray the current ordinary expenses of the different departments.' [reference omitted.] The State Department was unable to discharge its stationery bill; the 'treasury was obliged to borrow pitiful sums which it would disgrace a merchant in tolerable credit to ask for;' [reference omitted]; the War Department could not pay a bill for $3,500; 'the paymaster was unable to meet demands for paltry amounts—not even for $30;' [reference omitted]. . . ." Ralph C. H. Catterall, "The Second Bank of the United States" (1903), p. 6.

It was plain that a new central bank was needed. Yet it was not until 1816 that Congress passed and President Madison approved a bill to create one. Passage of the bill had been spurred by messages of both the President and the Secretary of the Treasury, Alexander J. Dallas, and also by the leadership of John C. Calhoun in the House. On December 5, 1815, Madison in his annual message to Congress had said: "It is . . . essential to every modification of the finances, that the benefits of a uniform national currency should be restored to the community . . . If the operation of the State banks cannot produce this result, the probable operation of a national bank will merit consideration." Quoted in M. St. Clair Clarke and D. A. Hall, "Legislative and Documentary History of the Bank of the United States" (1832), p. 609.

Secretary Dallas was more emphatic than the President in urging the creation of a national bank. He maintained that "[t]he establishment of a national bank is regarded as the best and perhaps the only adequate resource, to re-

lieve the country and the Government from the present embarrassments . . . A national bank will . . . possess the means and opportunity of supplying a circulating medium, of equal use and value in every district of every State. Established by the authority of the Government of the United States; accredited by the Government, to the whole amount of its notes in circulation; and entrusted as the depository of the Government, with all its accumulations of the public treasure; the national bank, independent of its immediate capital, will enjoy every recommendation which can merit and secure the confidence of the public'' (ibid. pp. 612-613).

Representative John C. Calhoun gave his strong support to Secretary Dallas's proposal. On February 26, 1816, he addressed the House at length, saying that he ''proposed to examine the cause and state of the disorders of the national currency, and the question whether it was in the power of Congress, by establishing a national bank, to remove those disorders'' (ibid. p. 630). The ''state of the currency,'' he observed, ''was a stain on the public and private credit'' (ibid. p. 631). He then proceeded to analyze its grave deficiencies and to consider the ways in which they might be remedied. A national bank, he concluded, was the answer. Such a bank, he said, ''paying specie itself, would have a tendency to make specie payments general, as well by its influence as by its example. It will be in the interest of the national bank to produce this state of things . . .'' (ibid. p. 633). ''The restoration of specie payments,'' he said, ''would remove the embarrassments on the industry of the country, and the stains from its public and private faith.''

Calhoun's efforts proved to be successful in securing passage of the bill. On April 10, 1816, President Madison signed it, and the now famous Second Bank of the United

States was born. 3 Stat. 266. "It was," as a leading financial historian has written, "a central bank in every sense of the word. It acted as the Federal Government's fiscal agent, issued notes, and dealt in bills of exchange. Its power to issue notes gave the Bank some control over the money supply, for it could increase or reduce the amount of money it issued." Herman E. Kroos, "The Historical Background of the American Banking System," in "The Federal Reserve System," Herbert V. Prochnow ed. (1960), pp. 1, 7.

The new bank was intimately connected with the government. The government was to subscribe to $7 million of the bank's $35 million capital (§ 1); the government's subscription could be made in "public stock" (§ 6); the Treasury was given a right of first refusal on the sale by the bank of government stocks (§ 5); the bank was to pay the government a bonus of $1.5 million in three equal annual installments (§ 20); five of the bank's twenty-five directors were to be appointed annually by the President of the United States with the advice and consent of the Senate (§ 8); the bank's notes were legal tender for all payments to the government (§ 14); government funds were required to be deposited in the offices of the bank or its branches unless the Secretary of the Treasury, for reasons that he was to submit to Congress, directed otherwise (§ 16); and the bank was required to furnish, without charge, "the necessary facilities for transferring the public funds from place to place within the United States, or the territories thereof, and for distributing the same in payment of the public creditors" (§ 15). Finally, Congress contracted that, except in the District of Columbia, "no other bank shall be established by any future law of the United States during the continuance of the corporation hereby created, for which the faith of the United States is hereby pledged" (§ 21).

This, then, was the Second Bank of the United States which came before this Court in *M'Culloch* v. *Maryland,* 4 Wheat. 316, and *Osborn* v. *Bank of the United States,* 9 Wheat. 738. Like the First Bank of the United States, it was, to use Alexander Hamilton's words in projecting his plan of the earlier institution, "not a mere matter of private property, but a political machine of the greatest importance to the State." ("Second Report on the Further Provision Necessary for Establishing Public Credit" in "The Papers of Alexander Hamilton," Harold C. Syrett (ed. 1963), pp. 305, 329.)

Little do we wonder, then, that Chief Justice Marshall, in *M'Culloch* v. *Maryland,* summarily said of the Second Bank of the United States "That it [the Bank] is a convenient, a useful, and essential instrument in the prosecution of its [the government's] fiscal operations, is not now a subject of controversy. All those who have been concerned in the administration of our finances, have concurred in representing its importance and necessity . . . The time has passed away when it can be necessary to enter into any discussion in order to prove the importance of this instrument, as a means to effect the legitimate objects of the government" (pp. 422-423). Recalling the financial chaos that had followed the failure to renew the charter of the First Bank, Marshall said: "The original act was permitted to expire; but a short experience of the embarrassments to which the refusal to revive it exposed the government, convinced those who were most prejudiced against the measure of its necessity, and induced the passage of the present law" (p. 402).

This was about all Marshall said of the bank's connection to the government. But, considering the recent financial chaos from which the bank had emerged, further statement or analysis was unnecessary. So plain was it to Marshall

that the bank was an "essential instrument in the prosecution of its [the government's] fiscal operations. . . ." (p. 422).

Marshall's almost axiomatic acceptance of the bank's governmental role was challenged in *Osborn* v. *Bank of the United States,* 9 Wheat. 738, which struck down as unconstitutional a tax of $50,000 a year imposed by Ohio on each of the bank's offices in that state. To the claim of the bank's constitutional immunity, the tax collector replied that the bank "originated for the management of an individual concern, to be founded upon contract between individuals, having private trade and private profit for its great end and principal object" (p. 859).

Marshall rejected this contention. "The bank," he said, "is not considered as a private corporation, whose principal object is individual trade and individual profit; but as a public corporation, created for public and national purposes" (p. 860). "The operations of the bank," he continued, "give its value to the currency in which all the transactions of the government are conducted. . . . The business of the bank constitutes its capacity to perform its functions, as a machine for the money transactions of the government. . . . Were the Secretary of the Treasury to be authorized by law to appoint agencies throughout the Union, to perform the public functions of the Bank, and to be endowed with its faculties as a necessary auxiliary to those functions, the operations of those agents would be as exempt from the control of the States as the Bank, and not more so" (p. 863). Continuing, he said, taking judicial notice of the government's financial problems, "That the [bank's] exercise of these [its banking] faculties greatly facilitates the fiscal operations of the government, is too obvious for controversy; . . . The currency which it circulates, by means of its trade with individuals, is believed to make it

a more fit instrument for the purposes of government, than it could otherwise be; . . ." (p. 864).

Such, then, was the original character of the great central bank that *Owensboro* relied on to support the conclusion that the isolated, uncoordinated federally chartered unit banks in 1899 were to be treated as federal instrumentalities. Questionable as the cases on the great Second Bank of the United States were as precedent for *Owensboro* in 1899, they are, we submit, so far as concerns the status of national banks as federal instrumentalities today, wholly inapplicable.

We recognize that, since *Owensboro*, cases have quoted its broad and easy doctrine. Yet in none of the succeeding cases, save the present one and the case of *Liberty National Bank & Trust Company* v. *Buscaglia*,—N.Y.—, — N.E. 2d—(Docket No. 203, Ct. of App., Dec. 29, 1967), has a court undertaken to re-examine the premises on which it rested. And, in each of these cases, unanimous courts found the premises to be completely eroded.[1]

We are aware of the dictum in *Department of Employment* v. *United States*, 385 U.S. 355, 360, that "the Red Cross is like other institutions—e.g., national banks—whose status as tax-immune instrumentalities of the United States is beyond dispute." "Beyond dispute" perhaps because of a bland acceptance of *Owensboro*. "Beyond dispute" perhaps because the appellant's brief in *Department of Employment*, in seeking to distinguish the Red Cross from genuine federal instrumentalities, conceded that "national banks are instrumentalities of the United States" (appellant's brief in *Department of Employment*, p. 25). Hence,

[1] Reexamination of the constitutional basis of the supposed immunity of national banks has been recommended by a leading authority on banking law. Howard H. Hackley, "Our Baffling Banking System," 52 Virginia Law Review, pp. 565, 771 (May and June, 1966) at p. 827.

not only was this Court not presented with any question of the correctness of *Owensboro*, it was actually requested by the state to assume that *Owensboro* was still good law. We do not join in that request. Rather, we urge the court to hold that a national bank today is a strictly private business enterprise that performs no functions of sufficient governmental importance to entitle it to any constitutional exemption from nondiscriminatory state sales and use taxes.

II. The Determination of the Massachusetts Supreme Judicial Court that the Legal Incidence of the Sales Tax is on the Vendor is a Binding Determination under State Law and is in Accord with Federal Criteria.

As the decision of the Massachusetts Supreme Judicial Court pointed out, any constitutional or statutory exemption that the appellant may claim "will be controlled by whether the purchaser or the vendor bears the legal incidence of the Massachusetts sales and use taxes" (A. 36). Concededly the incidence of the use tax is on the purchaser (A. 40). The incidence of the sales tax, however, as the Massachusetts court determined, is on the vendor. This, we submit, is a determination that should be accepted on the present appeal.

We recognize, as the appellant has argued (appellant's brief, pp. 41-45) that the United States Supreme Court is not bound by the "characterization" that a state court gives to its tax law when federal rights are involved. However, as *Society for Savings in Cleveland* v. *Bowers,* 349 U.S. 143, points out, the United States Supreme Court "would be bound by the state court's decision as to what rights and liabilities . . . [the] statute establishes under state law" (p. 151).

The Massachusetts court has determined what these rights and liabilities are. It held that neither the provi-

sion (subsection 3 of section 1) that "each vendor in this Commonwealth shall add to the sales price and shall collect from the purchaser the full amount of the tax," nor subsection 23 that prohibits as unlawful advertising the holding out by any vendor that he will assume or absorb the tax "singly or together, imposes any sanction on a vendor who chooses not to charge the tax" (A. 38-39).

The foregoing determination, we submit, is not subject to review in this case. It is a determination of rights and obligations under the law of Massachusetts only. Hence, it is not now open to the appellant to reargue whether Massachusetts law imposes any sanction for failure to add the tax to the sales price or to collect it from the purchaser (appellant's brief, p. 45 et seq.). Nor is it open to the appellant to reargue (appellant's brief, p. 46 et seq.) that subsection 7 of section 1 of the sales tax was not adequately considered in the Massachusetts court's opinion. Subsection 7 was in fact considered by the Massachusetts court (A. 37, footnote 8), but did not in any way alter the court's determination that the Massachusetts statute does not impose any sanction on the vendor who chooses not to charge the tax.

The Massachusetts court also made other determinations of rights and liabilities that the sales tax statute established under Massachusetts law. The court held that on some sales (not in excess of eighteen cents) the purchaser does not reimburse the vendor, and that the responsibility for payment to the Commonwealth is exclusively on the vendor (A. 37); that the vendor is the person to make returns and to pay the tax to the Commonwealth (A. 37-38); that assessment and collection of unpaid taxes through both criminal and civil remedies may be made only against the vendor (A. 38); that tax-abatement procedures are applicable only to vendors (A. 38); and that the Massachusetts

statute makes no provision permitting the Commonwealth to enforce the payment of the tax against a purchaser (A. 38).

Based on all the foregoing determinations, the Massachusetts court then ruled, quoting *Kern-Limerick, Inc.,* v. *Scurlock,* 347 U.S. 110, 121-122, that the legal incidence of the sales tax is on the vendor (A. 40) in that the vendor "is responsible . . . for payment to the state of the exaction" (A. 36). Since this determination has an independent state significance, namely the state's method of enforcement of its own tax, it is not subject to review, in relation to that aspect, on the present appeal. *Federal Land Bank of St. Paul* v. *Bismarck Lumber Co.,* 314 U.S. 95, 99.

If there is any federal aspect of the matter, it is only whether the Massachusetts court employed criteria that conflicted with the Constitution or laws of the United States, or employed proper criteria but applied them in such a way, *given the Massachusetts court's binding construction of the rights and liabilities under the Massachusetts statute,* as to create such a conflict. This, we believe, to be the teaching of the cases on this subject. *Clement National Bank* v. *Vermont,* 231 U.S. 120, 134. *Colorado National Bank of Denver* v. *Bedford,* 310 U.S. 41, 52. *Federal Land Bank of St. Paul* v. *Bismarck Lumber Co.,* 314 U.S. 95, 99. *Kern-Limerick, Inc.,* v. *Scurlock,* 347 U.S. 110, 119.

In the present case, we submit, the federal aspects were fully satisfied. The Massachusetts court used as its controlling test the rule enunciated in *Kern-Limerick,* at pp. 121-122—the determination of "who is responsible . . . for payment to the state of the exaction" (A. 36). In applying that test the Massachusetts court used an analysis which, we submit, fully comported with the federal standards enunciated in the cases cited. Having enumerated just above the factors that the Massachusetts court considered,

we will not restate them here. We submit that they were correctly applied in their federal aspect.

The appellee therefore concludes this portion of its argument by asserting that the Massachusetts court's holding that the legal incidence of the sales tax is on the vendor is correct and should be affirmed.

III. Title 12 U.S.C. § 548, neither Expressly nor Impliedly Prohibits a State from Applying a Nondiscriminatory Use Tax to Purchases by National Banks, and it may Not be Invoked by a National Bank to Claim an Immunity from a Nondiscriminatory Sales Tax when the Legal Incidence of the Latter Tax does Not Fall on the Bank.

The appellant argues that 12 U.S.C. § 548 (Rev. Sts. § 5219, as amended), is the exclusive source of the jurisdiction of the states to tax national banks, and that any state tax which is not enumerated therein is void. It is our position as the appellee that section 548 only defines the conditions under which the states may levy the kinds of taxes specifically mentioned in section 548, and does not outlaw the sales and use taxes involved in the present case. And, in any event, section 548 has no application to the Massachusetts sales tax, since, for the reasons already stated in this brief, the legal incidence of that tax, unlike the legal incidence of the use tax, does not fall on the bank as a purchaser.

Section 548 is set forth at pages 54-55 of the Appendix to the appellant's brief. This section, we observe, is not cast in the form of a prohibition or an exemption,[1] but

[1] Contrast 12 U.S.C. § 531: "Federal reserve banks . . . shall be exempt from Federal, State, and local taxation, except taxes on real estate." See also the numerous other contrasting statutory tax exemptions cited by the Massachusetts Supreme Judicial Court (A. 57, n. 23).

rather in the form of an enumeration of the conditions on which the states may tax the shares of national banks. It provides in pertinent part:

> "The legislature of each State may determine and direct, subject to the provisions of this section, the manner and place of taxing all the shares of national banking associations located within its limits. The several States may (1) tax said shares, or (2) include dividends derived therefrom in the taxable income of an owner or holder thereof, or (3) tax such associations on their net income, or (4) according to or measured by their net income, provided the following conditions are complied with . . ."

Observing that the foregoing section does not purport to grant an exemption, the Massachusetts court said:

> "Any construction of § 548 which would prohibit the imposition of a use tax upon a national bank must rest on implication since the section, by its terms, does not purport to prohibit any taxation." (A. 57.)

Yet such an implication is impermissible, since, as the Massachusetts court ruled, citing the following cases, the law is clear that tax exemptions are not granted by implication. *Graves* v. *New York ex rel. O'Keefe*, 306 U.S. 466, 480. *United States Trust Co.* v. *Helvering*, 307 U.S. 57, 60. *Oklahoma Tax Commission* v. *United States*, 319 U.S. 598, 604. *Oklahoma Tax Commission* v. *Texas Co.*, 336 U.S. 342, 366. This rule has an especially fitting application to a lost intergovernmental immunity. As the Massachusetts court said, quoting *Oklahoma Tax Commission* v. *Texas Co.*, 336 U.S. 342, 366, "[t]he immunity formerly

said to rest on constitutional implication cannot now be resurrected in the form of statutory implication."

Actually, the appellant in the present case seeks more than resurrection of an original immunity. The immunity that the appellant would have this Court resurrect is an immunity that was given, not by section 548 when first enacted, but rather by later judicial departures. It is now time to return to the original meaning.

Section 548 began with a proviso in section 41 of the National Currency Act of 1864 (13 Stat. 99). That section stated first that, "in lieu of all existing taxes," national banks were to pay to the federal government taxes on their circulating notes, deposits and capital (beyond the amount invested in United States bonds). This was followed by three provisos, which read:

> "*Provided,* That nothing in this act shall be construed to prevent all the shares in any of the said associations, held by any person or body corporate, from being included in the valuation of the personal property of such person or corporation in the assessment of taxes imposed by or under state authority at the place where such bank is located, and not elsewhere, but not at a greater rate than is assessed upon other moneyed capital in the hands of individual citizens of such state: *Provided, further,* That the tax so imposed under the laws of any state upon the shares of any of the associations authorized by this act shall not exceed the rate imposed upon the shares in any of the banks organized under authority of the state where such association is located: *Provided, also,* That nothing in this act shall exempt the real estate of associations from either state, county, or municipal taxes to the same extent, according to its value, as other real estate is taxed."

The striking feature of these provisos is that they were framed, not in terms of a grant of jurisdiction to the states, but rather in terms of the regulation of a jurisdiction that the states already possessed. Good tax and constitutional reasons justified the use of this form of statement.

The tax reasons stemmed from the structure of the state tax systems in 1864. A careful student of the relation of these sections to section 548 (Rev. Sts. § 5219, as amended) has written: "At the time of the enactment of Section 5219, the general property tax was the almost universal source of state and local revenue, and it was for this system that the section was intended." Ronald B. Welch, "State and Local Taxation of Banks in the United States," Special Report No. 7 of the State Tax Commission of the State of New York (1934), p. 21.

The constitutional reasons had their roots in *M'Culloch* v. *Maryland*. Still fresh in 1864 was Chief Justice Marshall's important qualification in that case:

> "This opinion does not deprive the States of any resources which they originally possessed. It does not extend to a tax paid by the real property of the bank, in common with the other real property within the State, nor to a tax imposed on the interest which the citizens of Maryland may hold in this institution, in common with other property of the same description throughout the State." 4 Wheat. at 436.

The continuing vitality of the foregoing qualification was manifested in *Van Allen* v. *Assessors,* 3 Wall. 573, decided in 1865. In rejecting an argument that the provisos were unlawful delegations of federal power to the states, this Court declared:

> "It is said that Congress possesses no power to confer upon a State authority to be exercised which

has been exclusively delegated to that body by the Constitution, and, consequently, that it cannot confer upon a State the sovereign right of taxation; nor is a State competent to receive a grant of any such power from Congress. We agree to this. But as it respects a subject-matter over which Congress and the States may exercise a concurrent power, but from the exercise of which Congress, by reason of its paramount authority, may exclude the States, there is no doubt Congress may withhold the exercise of that authority *and leave the States free to act.*" 3 Wall. at 585. (Emphasis added.)

Such, then, is the tax and constitutional background against which the enactment of the provisos in 1864 should be judged. The debates leading to their adoption are also relevant, and we, like the appellant, have examined them. We agree with the appellant that the debates ended in a compromise (appellant's brief, p. 17). But we differ with the appellant on the nature of the settlement. It was not a compromise by which Congress granted jurisdiction to the states; rather it was a compromise by which Congress preempted for the federal government jurisdiction to tax the circulating notes, deposits and capital of the national banks and left to the states, subject to certain safeguards against discriminatory action, their preexisting jurisdiction to tax shares and real estate.

This declaratory nature of section 5219 (the section of the Revised Statutes into which the provisos were later incorporated) in respect of the states' jurisdiction was reaffirmed in 1877. In *Adams* v. *Nashville*, 95 U.S. 19, this Court stated:

"The act of Congress [section 5219] was not intended to curtail the State power on the subject of

taxation. It simply required that capital invested in national banks should not be taxed at a greater rate than like property similarly invested." (At p. 22.)

In 1899, however, there was a sudden and, we submit, an erroneous departure from the earlier determinations. Reversing the original construction of the statute, *Owensboro National Bank* v. *Owensboro*, 173 U.S. 664, ruled that the provisos, instead of being declaratory of the jurisdiction of the states, were the source of the states' power to tax national banks. Subsequent cases, as the appellant indicates (appellant's brief, pp. 10-11), have repeated the *Owensboro* proposition.

Still, the original purpose of the provisos has not been forgotten. In *Clement National Bank* v. *Vermont*, 231 U.S. 120, the Court said:

> "The object [of section 5219] is to prevent hostile discrimination and for this purpose a standard is fixed." (At p. 135.)

And in *Des Moines National Bank* v. *Fairweather*, 263 U.S. 103, 116, the Court said, with respect to the section:

> "Its main purpose is to render it impossible for the State, in levying such a tax, to create and foster an unequal and unfriendly competition, by favoring institutions or individuals carrying on a business similar to that of national banks or engaging in operations and investments of a like character; . . ."

Nor, in fact, has the *Owensboro* proposition itself gone unchallenged. In *Bank of California* v. *Richardson*, 248 U.S. 476, which held that a state could not tax a national bank on stock held in a state bank, since this was a subject

of taxation not mentioned in the provisos, there was a dissent by Mr. Justice Pitney, who said:

> "Upon the last point I understand the case to be controlled by the decision of this court in *Owensboro National Bank* v. *Owensboro,* 173 U.S. 664, where it was held that § 5219 had the effect of exempting not only the operations and franchises but the property of the national banks from state taxation, except as to their real estate. There are weighty considerations to the contrary, which seem not to have been called to the attention of the court in that case—certainly are not adverted to in the opinion—but it would serve no useful purpose to bring them into the present discussion." (pp. 488-489.)

We believe that a useful purpose would now be served by returning to the original understanding of that section.

Subsequent congressional amendments of the section are consistent with our position. The 1923 amendment (Act of March 4, 1923, c. 267, 42 Stat. 1499) and the 1926 amendment (Act of March 25, 1926, c. 88, 44 Stat. 223) were passed as responses to the possibility, after the decision in *Merchants' National Bank of Richmond, Virginia* v. *Richmond,* 256 U.S. 635, that taxes on national bank shares might be held to be violative of section 5219 in states where taxes on income from certain other moneyed capital was levied at a lower rate than property taxes on the shares. See Ronald B. Welch, "State and Local Taxation of Banks in the United States," p. 41, *supra,* at pp. 36-43. The 1923 and 1926 amendments accordingly liberalized the conditions of state taxation of national-bank shares, taking into account new forms of taxation.

As in the original provisos in 1864, Congress, in passing the amendments, did not speak in terms of the national

banks enjoying an exemption, but only in terms of each state determining "the manner and place of taxing all the shares of national banking associations located within its limits." 12 U.S.C. § 548.

The appellant has invoked this statute in the present case to obtain an exemption from nondiscriminatory sales and use taxes. We deny that the statute grants such an exemption, and justice does not warrant one. Indeed, it would be ironical if the regulation of taxation of national bank shares, framed to prevent discriminatory treatment of national banks, should now become the means by which these banks would receive an exemption and an advantage denied to their competitors, the state-chartered banks. Yet this is the result that the appellant seeks. It is a result that would amount to an expansion, by judicial decree, of federal restrictions on state taxation of national banks.

The existing congressional scheme of regulation is framed in terms of an enumeration of the standards and conditions on the imposition of certain state taxes. These taxes—property taxes, income taxes, and taxes measured by income—have a direct bearing on the value of an investment in a national bank as compared to an investment in other moneyed capital. Sales and use taxes, on the other hand, such as those in the present case, which by their terms fall impartially on both national and state banks and all other financial institutions, are inherently equal. Thus no supplemental restriction by Congress or by this Court is required to ensure equality of their practical application. *Tradesmens National Bank of Oklahoma* v. *Oklahoma Tax Commission*, 309 U.S. 560, 567. *Michigan National Bank* v. *Michigan*, 365 U.S., 467, 472-473.

We therefore conclude this section of our brief by requesting the Court not to read into section 548 the implied preferential exemption that the appellant seeks.

Conclusion.

The appellee submits that the judgment of the Massachusetts Supreme Judicial Court was correct in all respects, and should be affirmed.

Respectfully submitted,

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